

Estate of Confusion

- What The Crystal Ball Says
- Planning Techniques

Where We Are

EGTRRA 2001 contained a sunset provision by which on January 1, 2011, tax provisions would revert to their 2001 levels

Literally, overnight we faced moving from no estate tax to reversion to the 2001 levels:

- \$1,000,000.00 exclusion
- 55% rate

The Middle Class Tax Relief Act of 2010

- \$5,000,000.00 estate exclusion
 - 35% maximum rate

Unifies Estate and Gift Treatment
\$5,000,000 gift tax exemption with 35% rate

That's the good news.....

The Middle Class Tax Relief Act of 2010

Now for the bad....

Sunsets on December 31, 2012, at which point
we return to the 2001 levels, absent
congressional action and the President's
signature

Deja vu all over again.....

“The most favorable wealth transfer planning provisions in modern history”

“The golden age of wealth transfer”

Where are we headed?

The President's 2012 proposed budget called for a return to the 2009 levels:

\$3,500,000 exemption
45% maximum rate

Congress has some different ideas.....

H.R. 25 – The Fair Tax Act

- Sponsored by Rep. Rob Woodall (R-Ga)
 - Repeals Estate, Gift and GST Tax
 - Also repeals Income and payroll taxes, replacing all with a sales tax
- The seventh Congress in which it has been introduced

H.R. 26 – End Tax Uncertainty Act of 2011

- Sponsored by Rep. Michelle Bachmann (R-Mn)
- Would repeal estate, gift and GST taxes retroactive to January 1, 2011

H. R. 99 – Fair and Simple Tax Act of 2011

- Sponsored by Rep. David Dreier (R-Ca)
- Would repeal estate gift and GST tax effective retroactive to January 2, 2011

H. R. 123 – Act to Amend the IRC of 1986

- Sponsored by Rep. Phil Gingrey (R-Ga)
 - Would repeal estate and GST tax
- Would keep gift tax with \$1,000,000 exemption at 35% rate

H. R. 143 – Permanently Repeal the Estate Tax Act of 2011

- Sponsored by Rep. Robert E. Latta (R-Oh)
- Entire Text: “Effective for estates of decedents dying after December 31, 2010, Chapter 11 of Subtitle B of the IRC of 1986 is repealed.”

A concise man, Mr. Latta.....

H.R. 177 – Estate Repeal Act of 2011

- Sponsored by Rep. Mac Thornberry (R-Tx)
- Would repeal estate, gift and GST tax

H. R. 696 and S.B. 13

- Sponsored by Mike Pence (R-In) and Jim DeMint (R-SC)
- Would repeal the sunset provisions of EGTRRA
- Retroactive to January 1, 2010

H. R. 1259 – Death Tax Repeal Permanency Act of 2011

- Four initial sponsors (2 Republicans, 2 Democrats)
 - Repeal estate and GST tax
- Maintain gift tax at 35% with a \$5,000,000 exemption
 - 169 co-sponsors
- Likely to pass House, unlikely to pass Senate

What Does It All Mean?

Smart Money: Bet on something more like the Obama plan than anything we're seeing in either House of Congress

- Effect of Insurance Lobby
- Need for revenue

How To Take Advantage

Factors working in your favor:

- Historically low 7520 rates
- Depressed asset values
- High gift tax exemption

Grantor Retained Annuity Trust (GRAT)

- A planning technique based primarily on interest rate assumptions
- Use assets likely to earn more than the 7520 rate
 - Appreciation in assets passed out to beneficiaries

GRAT

- Grantor retains annuity interest for a term of years
 - Amount of the taxable gift is the fair market value of the property at the time of transfer less the Grantor's retained annuity interest

GRAT

- At the conclusion of the term of the GRAT, the assets are passed out to the beneficiaries selected by the Grantor
 - Outright or in further Trust

GRAT

- If the Grantor dies during the term, the value of the property is included in the Grantor's taxable estate
 - This is the primary down side

GRAT

The IRS assumes the assets will produce a return equal to the 7520 rate applicable to the month of the transfer

If the assets out-perform the 7520 rate, the increase in value is passed to the remainder beneficiaries free of gift tax

Recall, the 7520 rate is historically low.....

GRAT

- The December, 2011 7520 rate is 1.6%
- Therefore, any appreciation over 1.6% is passed out to beneficiaries as a gift, free of gift tax

Zeroed-Out GRAT

- The only other potential down side is the imposition of gift tax at the creation of the GRAT
 - This is remedied by creating a zeroed-out GRAT, where the Grantor's retained annuity interest is equal to the value of the property transferred to the Trust
 - No gift tax results

Where should a GRAT be used?

Leverage unified credit gift with no downside risk:

As long as the assets outperforms the 7520 rate, the children win

Where should a GRAT be used?

Client has no unified credit remaining:

Zeroed-out GRAT where client has exhausted unified credit

Where should a GRAT be used?

Assets with significant short-term appreciation potential

Qualified Personal Residence Trust QPRT

A properly structured QPRT will freeze the value of the residence at the time the trust is created

QPRT

Grantor creates a Trust and transfers a personal residence to the Trust. There is gift tax imposed at the transfer equal to the value of the residence

QPRT

During the term of the QPRT, the Grantor retains possession and enjoyment of the residence tax-free and is responsible for maintenance and upkeep

QPRT

If the Grantor survives the term of the QPRT, the residence becomes the property of the remaindermen

QPRT

At the conclusion, the Grantor can continue to dwell in the residence with fair-market rent paid to the beneficiaries, thereby creating another opportunity to move assets out of the Grantor's estate

QPRT

Here, however, the low 7520 rate works against the Grantor.

The higher the rate, the lower the gift value and the lower the potential gift tax. Conversely, a low federal interest rate usually translates into lower estate tax savings.

QPRT

However, the undervaluation of the property subject to the transfer might offset the detriment of the low 7520 rate

Recall, you're locking in the present value of the property transferred

Loans to Family Members

December, 2011 Rates

Short Term: .2%
Mid Term: 1.27%
Long Term: 2.8%